In The

# Supreme Court of the United States

October Term, 1976

No. .....
Civil 76-1393

JACK D. RINGWALT,
*Petitioner,*

vs.

UNITED STATES OF AMERICA,
*Respondent.*

PHILIP L. LIESCHE and URSULA A. LIESCHE,
*Petitioners,*

vs.

UNITED STATES OF AMERICA,
*Respondent.*

JACK D. RINGWALT and JEAN W. RINGWALT,
*Petitioners,*

vs.

UNITED STATES OF AMERICA,
*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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TO: THE HONORABLE: The Chief Justice and Associate Justices of The Supreme Court of The United States:

Your petitioners respectfully pray that a writ of certiorari issue to review the judgment and decision of the United States Court of Appeals for the Eighth Circuit entered in the above actions on February 16, 1977.

## OPINIONS BELOW

The opinion of the United States Court of Appeals is not yet reported in the Federal Reporter. A copy of the opinion appears at pages 1-9 in the separate Appendix furnished herewith. The opinion of the United States District Court is unreported. This opinion also appears in the Appendix at pages 11-16.

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## GROUNDS OF JURISDICTION

The judgment sought to be reviewed is a judgment of the United States Court of Appeals for the Eighth Circuit entered February 16, 1977. See Appendix, page 10. This judgment affirmed the judgment of the United States District Court for the District of Nebraska, Honorable Robert V. Denney, United States District Judge presiding (Appx. 16).

There was no petition for rehearing filed herein and there have been no extensions of time within which to petition for certiorari.

The statutory provision believed to confer on this Court jurisdiction to review the judgment in question by writ of certiorari is 28 U. S. C. Section 1254 (1).

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## QUESTIONS PRESENTED FOR REVIEW

1. The principal question presented for review of this Court, broadly stated, follows:

Where a corporation which operated an insurance agency sold securities held by it as an investment and was then dissolved, and the proceeds of the liquidation were distributed to the stockholders including a bona fide Clifford trust which owned 84% of the stock, and a new agency corporation was then formed to which the operating assets of the agency were sold for valid consideration, and the trust acquired no stock in the new corporation but the grantor-trustee individually acquired 84% of the stock of the new corporation and the minority stockholders of the old corporation acquired, proportionately, the same interests in the new corporation they had held in the old one, was the transaction taxable as a corporate liquidation under 26 U. S. C. §§ 331 and 337 as contended by taxpayers, or was the transaction taxable as a "reorganization" under §§ 368 (a) (D) and 368 (c), as contended by the Treasury?

The Court of Appeals held in effect that the grantor-trustee had "beneficial ownership" of the trust estate in view of his broad powers of administration and his reversionary interest in the corpus, and that there was therefore "continuity of interest" sufficient to authorize taxation of the transactions involved under the reorganization statutes.

2. A subsidiary question, assuming arguendo the existence of a reorganization, is whether the distribution made which was added to the corpus of the trust was taxable to the grantor-trustee as ordinary income in 1967, the year of

its receipt by the trust, rather than in 1969, the year of the termination of the trust and actual receipt of the trust corpus by the grantor-trustee.

The Court of Appeals disposed of this contention by footnote stating it was not raised in the trial court and in any event was contradicted by the court's conclusion that the grantor-trustee was the owner of the trust.

## STATUTORY PROVISIONS INVOLVED

The statutory provisions pertinent to this case are found in the Appendix at pages 16-24. Also found therein at pages 24-28 is particularly important and informative legislative history regarding subpart E of Part 1 of Subchapter J, 26 U. S. C. §§ 671-678, relating to the treatment of grantors and others as substantial owners for income tax purposes, and disclosing the congressional intent to mandate recognition and protection of rights of a grantor-trustee of a Clifford trust, as against claims that he is a substantial owner for income taxation purposes.

The sections of the Internal Revenue Code of 1954 (26 U. S. C.) pertinent to the issues herein follow:

**(Corporations—Liquidations and Reorganizations)**

§ 318 (a) (2) (B) (i) and (ii). (Appx. 16, 17)

§ 318 (b) (Appx. 17, 18)

§ 331 (a) (1) (Appx. 18)

§ 337 (a) (1) and (2). (Appx. 18)



§ 356 (a) (1) (A) and (B). (Appx. 18, 19)

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§ 368 (a) (1) (D). (Appx. 19)

§ 368 (c). (Appx. 20)

**(Trusts)**

§ 643 (a) (3). (Appx. 20)

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§ 674 (b) (2) (8). (Appx. 23)

§ 676 (a) (Appx. 23)

§ 676 (b) (Appx. 23, 24)

§ 677 (a) (2) (Appx. 24)

## STATEMENT OF THE CASE

### Procedural Facts

Separate actions were brought by petitioners and by Charles E. Wortz and wife in the United States District Court for the District of Nebraska for refund of Federal Income Taxes and interest paid by reason of deficiencies assessed by the Director of Internal Revenue for the taxable year 1967. The actions involved common issues of fact and law and were consolidated for hearing and dis-

position. Jurisdiction was invoked under 28 U. S. C. § 1340, each of the actions having been timely filed more than six months after the timely filing of refund claims under § 6511 and § 6532 of the Internal Revenue Code of 1954, as amended. Venue was grounded on 28 U. S. C. § 1391 (f).

The parties entered into a stipulation of facts and the cause was tried to the court without a jury on the stipulation and the undisputed testimony of petitioner Jack D. Ringwalt.

The District Court, the Honorable Robert V. Denney, determined the issues in favor of defendant and against the plaintiffs who are the petitioners herein. The District Court's memorandum opinion appears in the Appendix, pages 11-16, and its judgment at page 16 thereof. Motions for a new trial were overruled and appeals to the Court of Appeals pursuant to 28 U. S. C. § 1291 followed.

The plaintiffs Wortz and wife did not appeal because of the relatively small amount involved in their case. The appeals were separately docketed but were consolidated for briefing and submission. The judgment of the District Court was affirmed by the Court of Appeals. See Appendix pages 10, 11 and this petition for certiorari seeks review of the judgment of that Court.

## Substantive Facts Material to Consideration of Questions Presented

The pertinent facts are undisputed and are found in the stipulation and the testimony of taxpayer Jack D. Ringwalt (hereafter sometimes referred to as "Ringwalt"). We summarize them.



Ringwalt and Liesche, Inc ("R & L, Inc.") was a Nebraska corporation organized July 1, 1949, to conduct a general insurance agency. Prior to April 30, 1959, the stockholders and their respective percentage of shares were Daniel J. Gross (2%), Philip L. Liesche ("Liesche") (8%), Ringwalt (84%), and Charles B. Wortz (6%). On the death of Mr. Gross in November, 1957, his stock was acquired by his surviving widow, Louise E. Gross. Messrs. Ringwalt, Liesche, and Wortz were the officers and directors of R & L, Inc., responsible for conduct of its business.

On April 30, 1959, Ringwalt established a short-term (or "Clifford") trust and delivered to himself as trustee all the shares he owned in R & L, Inc. The trust beneficiaries were Ringwalt's children who were entitled to the net income from the trust corpus. The trust was to continue for a period of ten years and one day and thus terminated May 1, 1969.

National Indemnity Company ("National Indemnity") and National Fire and Marine Insurance Company ("National Fire & Marine") were Nebraska insurance corporations. National Indemnity was formed by Ringwalt who was its controlling stockholder. At the beginning of 1967, approximately 51% of National Fire & Marine stock was held as an investment by R & L, Inc.

On February 23, 1967, formal offers were made by Berkshire-Hathaway, Inc., a Massachusetts corporation, to all the stockholders of National Indemnity and of National Fire & Marine to purchase their stock. On March 16, 1967, R & L, Inc. received $839,100 for the transfer of its shares of stock of National Fire & Marine with a cost basis of $132,798.13, and thereby gained $706,301.87. The net pro-

ceeds of the sale, along with other cash in the treasury of R & L, Inc., were thereafter credited or distributed by R & L, Inc., to its stockholders on a pro rata basis.

On February 22, 1967, the stockholders of R & L, Inc., by resolution directed the dissolution and liquidation of that corporation at the close of business on March 31, 1967. It was contemplated that insurance dailies and associated assets owned by R & L, Inc., would be sold to a new corporation to be formed and to commence business on April 1, 1967, R & L, Inc., was then dissolved and liquidated; and a new corporation, Ringwalt & Liesche Company ("R & L Co.") was incorporated on April 1, 1967.

Pursuant to the decision of the stockholders of the new corporation, its issued stock was held in the relative percentages of the shares in the old corporation except that while Ringwalt as trustee of the Clifford trust had held 84% of the share of R & L, Inc., Ringwalt in his individual capacity, acquired 84% of the shares of R & L Co. and the trust acquired none. Ringwalt, Liesche, and Wortz were the officers and directors of the new company. Wortz remained with the new corporation solely to train a successor and retired April 7, 1967.

The stockholders of R & L Co. paid R & L, Inc., $5,000 for the use of the similar corporate name and $165,000 for acquisition of insurance dailies and associated assets, which had been appraised by an independent appraiser.

On April 1, 1967, R & L, Inc., distributed funds to its stockholders in dissolution and liquidation, including $932,754.06 to Ringwalt as trustee of the Clifford trust and $88,833.72 to Liesche.



When the stock held by Ringwalt as trustee was redeemed, the proceeds were immediately reinvested in publicly held securities, and the trust continued without involvement with the new corporation. Ringwalt did not invest trust funds in the new R & L Co. because he felt that such an investment was too speculative in the absence of control formerly enjoyed by the old R & L, Inc., over National Indemnity, in which the insurance agency placed 80 to 90 per cent of its insurance business. Also, the new company contemplated seeking tax treatment under "Subchapter S" (26 U. S. C. §§ 1371, et seq., relating to taxable status of small business corporations), which, under the provisions of the Internal Revenue Code, would be impossible if the trust became a stockholder.

On Schedule D of his 1967 Federal Income Tax Return Ringwalt reported net long-term capital gain of $5,432,689.64, which total included $887,657.34 by reason of distribution of $932,754.06 by R & L, Inc., to Ringwalt as trustee in exchange for the shares of stock in R & L, Inc., with a reported cost basis and expenses of $45,096.72. On his 1967 Income Tax Return Schedule D, Liesche reported long-term gain of $124,502.28, including $68,142.74, by reason of distribution by R & L, Inc., of $88,833.72 in exchange for his stock with a reported cost basis and expenses of $20,690.88.

Having timely complied with requirements for reporting adoption of a plan to complete liquidation, R & L, Inc., did not report or treat as gain or other income subject to Federal taxation the net profit otherwise realized by sale of its National Fire and Marine stock.

The District Director determined that R & L, Inc., had underpaid its income tax for the fiscal year ending March

31, 1967, in the amount of $176,575.76 as tax upon a gain of $706,301.87 from the sale of its shares of stock in National Fire & Marine. This amount was assessed against Ringwalt as transferee of assets of the then dissolved R & L, Inc., and on November 18, 1971, was paid by Ringwalt, together with interest in the sum of $46,879.58. Claim for refund was filed May 16, 1972, and was disallowed December 26, 1972.

The District Director also determined that the 1967 gains reported as a result of distribution by R & L, Inc., to the Clifford trust and to Liesche, were ordinary income having the status of dividends for tax purposes, and assessed deficiencies against Ringwalt personally in the sum of $150,347.97 and Liesche in the sum of $11,401.18. On November 18, 1971, the deficiencies were paid, together with interest in the sum of $32,374.25 by Ringwalt and $2,446.69 by Liesche. Claims for refund were filed May 16, 1972, and were disallowed December 26, 1972. Thus, this proceeding involves approximately $406,175 as to the Ringwalt cases and approximately $13,848 as to the Liesche case.

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## ARGUMENT AMPLIFYING REASONS FOR ALLOWANCE OF WRIT

This case presents important questions of Federal law which have not been and should be settled by this Court. Likewise, it presents questions of interpretation of Internal Revenue laws relating to Clifford trusts as applied to corporate liquidations and reorganizations. In this connection, it involves a construction of the applicable Federal laws by the courts below in a manner calculated to thwart the intention of Congress and in conflict with principles heretofore recognized by this Court and by other Courts of Appeals.



We respectfully submit that the proceeding involved herein represents an attempt by the Treasury, successful to date, to refuse proper recognition of a Clifford trust as applied to the undisputed facts because in the particular instance the impact on the taxpayers involved is far in excess of what would result if the Clifford trust were properly and fully recognized. Faced with the amendments to the Internal Revenue Code of 1954 relating to Clifford trusts, the Treasury does not openly challenge the trust itself but it flatly declines to accord to it and to the grantor-trustee and his business associates the protection mandated by Congress.

Admittedly, the subject trust was a bona fide one set up eight years before the transactions involved took place and had two years to run thereafter. However, the Treasury insists that the grantor-trustee was the owner of the trust during the ten-year duration thereof, notwithstanding specific and repeated statutory provisions to the contrary and legislative history which amplifies those provisions and makes them abundantly clear.

At the threshold, the following observations are in order. The primary purpose of the statutes regarding taxation in case of corporate reorganizations was to permit such reorganizations in appropriate instances without prohibitive tax increments. *Gorman v. Commissioner of Internal Revenue*, 302 U. S. 82, 82 Law Ed. 63, although addi-

tional tax burdens may and often do result from a reorganization. Under applicable statutes a corporate reorganization with favorable tax consequences is permitted within clearly defined limits, but a corporate reorganization without adequate business purpose is impermissible.

In the present case it was entirely unnecessary to create a new corporation upon dissolution of R & L, Inc., or to reorganize the old one, in order to carry on the insurance agency business. The business could have been conducted just as well and as efficiently by the use of a limited partnership with Mr. Ringwalt as the general partner and his business associates as limited partners, and to borrow language from the opinion of the Court of Appeals in *Commissioner of Internal Revenue v. Bergash,* 2 Cir., 1966, 361 F. 2d 257 at page 260, it is "inconceivable" that the taxpayers herein would intentionally have reincorporated if this would require the additional drastic tax burden imposed by the Treasury. As stated in *Bergash* "to adopt the Commissioner's contention would do violence to the plain meaning of the statutes". We submit that here, as in *Bergash,* the Treasury, without justification, "condemns any result which would allow a shareholder to withdraw accumulated earnings at capital gains rates in a reincorporation transaction * * * ". We further submit that the decision of the Court of Appeals herein conflicts with that of the Second Circuit in *Bergash.*

A central and ironical defect of the decision sought to be reviewed is that it opens the door for the astute tax practitioner upon the very evil trafficing in the tax advantage of accumulated corporate net operating losses which 26 U. S. C. Section 368 was originally adopted to combat



through the error of misconstruing as a "mere reorganization" and, therefore, as one continuous corporate entity liquidated predecessor and newly organized successor corporations in the first of which an individual personally owned at least 80% of its shares and in the second of which the same individual as trustee of a short-term ("Clifford") trust held at least 80% of its shares for income beneficiaries with reversion of principal. In the particular involved instance, the existence of a "mere reorganization" benefited tax revenue collection by transforming what the taxpayer had reported as long-term capital gain into ordinary dividend income; but, if the decision below is sustained, it offers a technique by which the shareholders of a profit corporation can acquire a loss corporation and shelter income from taxation despite the carefully worked out rules of Section 368.

It is quite impossible to avoid argument on the merits in support of our petition for allowance of the writ. We do, however, limit our argument to what we deem essential to establish that certiorari is in order. If it is granted we shall amplify that argument and examine more fully the reasoning of the Court of Appeals and the correctness of its ultimate determination.

### Historical Background of Clifford Trusts

In 1940, this Court decided *Helvering v. Clifford,* 309 U. S. 331, 81 L. Ed. 788, 60 S. Ct. 554, which held that while the short-term trust involved therein was not taxable under § 166 of the Internal Revenue Code of 1939 [corresponding to § 676 of the 1954 Code as modified (Appx. 23)], it was taxable under the general provisions

of § 22a (now § 61) broadly defining gross income.[1] The majority opinion in *Clifford* pointed out that its construction of the law was premised on the absence of "more precise standards or guides supplied by statute" or regulations.

*Clifford* was followed by a series of Court decisions and administrative rulings which culminated in the additions and revisions contained in Subpart E of Part 1 of sub-chapter J of the Internal Revenue Code of 1954, 26 U. S. C. § 671, et seq., relating to grantors and others treated as substantial owners, wherein precise standards were enunciated.

As stated in the House Report concerning § 671 (Appx. 25):

> "It is also provided in this section that no items of a trust shall be included in computing the income or credits of the grantor (or another person) solely on the grounds of his dominion and control of the trust under the provisions of section 61 (corresponding to sec. 22(a) of existing law). *The effect of this provision is to insure that the taxability of Clifford type trusts, shall be governed solely by this subpart.*" (Emphasis added.)

The statutes relating to treatment of a trustee-grantor as a substantial owner for income taxation purposes and having relevance here are set out in the Appendix at pages 20 to 24. They are sections 671, 673, 674, 676, and

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1 The Court will note the strong dissenting opinion of Mr. Justice Roberts in which Mr. Justice McReynolds joined. See also **Helvering v. Wood,** 309 U. S. 344, 84 L. Ed. 797, 60 S. Ct. 551, decided on the same day as **Clifford,** and also holding that the short-term trust involved was not taxable under § 166.



677 which, being in pari materia, must be construed together. All of these statutes recognize that the grantor of a bona fide Clifford trust shall not be treated as the owner thereof for taxation purposes prior to the expiration of the 10-year period requisite to validity of the trust.

Section 673 (a) of the Internal Revenue Code (Appx. 22) sets out the general rule regarding reversionary interests and provides that the grantor shall be treated as the owner of any portion of the trust in which he has a reversionary interest "in either the corpus or the income therefrom *if, at the inception of that portion of the trust*" the interest will or may reasonably be expected to take effect in possession or enjoyment "*within ten years*" commencing at the date of the transfer of that portion of the trust. (Emphasis added.)

Under 26 U. S. C. 671 (Appx. 21), mere domination and control over the trust is declared to be insufficient to require items of a trust to be included in computing taxable income and credits of the grantor except as specified in Subpart E (26 U. S. C. §§ 671-678). Section 674 (Appx. 22) relating to power to control beneficial ownership excepts a power which can only affect beneficial ownership of the income for a period commencing after expiration of the period such that the grantor would not be treated as the owner under § 673 if the power were a reversionary interest. Section 676 (Appx. 23) relating to power to revoke contains substantially the same provision.

Section 677 (Appx. 24) relates to income for the benefit of the grantor. It requires the grantor to be treated as the owner of any portion of the trust whose income, at the discretion of the grantor, may be held or accumulated for

future distribution to the grantor. It then specifically provides:

> "*This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under § 673 if the power were a reversionary interest;* but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished." (Emphasis added.)

## The Question Whether There was a "Liquidation" or a "Reorganization"

The principal question presented is whether there was a "complete liquidation" of R & L, Inc., or a mere "reorganization" thereof for Federal income tax purposes. The courts below held that there was a "reorganization" because the taxpayer Ringwalt who was the grantor-trustee of the Clifford trust which owned 84% of the stock of R & L, Inc., acquired individually 84% of the stock in R & L Co.

That there was a dissolution and liquidation of R & L, Inc., is not disputed and it is settled law that a "complete liquidation" as distinguished from a "reorganization" is not precluded by the fact that the business venture involved is continued by a newly organized corporation. See *Commissioner of Internal Revenue v. Bergash*, 2 Cir. 1966, 361 F. 2d 257, affirming 43 T. C. 743; *Joseph C. Gallagher*, 1962, 39 T. C. 144; *Rommer v. U. S.*, D. C. N. J. 1966, 268 F. Supp. 740; 26 U. S. C. §§ 331 (a), 337 (a) (Appx. 18).

The reorganization statutes involved, 26 U. S. C. § 368 (a) (1) (D) and § 368 (c), are set out in the Appendix at



pages 19, 20. Paragraph (D) of § 368 (a) (1) defines as a "reorganization" a transfer by a corporation of assets to another corporation if, immediately after the transfer, the transferor corporation, one or more of its stockholders, or any combination thereof, is *in control* of the corporation to which the assets are transferred. Section 368 (c) defines "control" as *ownership* of stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote, and of all other classes of stock of the involved corporation. The Court of Appeals held that Ringwalt individually was appropriately treated as the owner of 84% of the R & L, Inc., stock because of "the significant incidence of his ownership over the trust property". It held that assessing continuity of interest depended upon "beneficial ownership without regard to the existence or absence of legal title". The Court of Appeals pointed out that Ringwalt had numerous powers of administration over the trust and retained a reversionary interest in the corpus and stated "the trust assets were subject to execution by Ringwalt's creditors".[2] The Court of Appeals stated that "Most significantly, examination of the declaration of trust reveals that Ringwalt as trustee possessed extensive power to allocate trust receipts between principal and income".

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2 The Court of Appeals cites no case to sustain this conclusion. The Court apparently relied upon a similar statement in the appellee's brief in the Court of Appeals which cited in support of such statement **First National Bank of Omaha v. First Cadco Corp.**, (1973) 189 Neb. 734, 205 N. W. 2d 115. That case involved a spendthrift trust and held that the trust corpus could be garnished after and only after the trust expired and the beneficiary had a right to demand the proceeds. Thus, the case is not authority for a proposition that the trust assets would be subject to execution by Ringwalt's creditors prior to the expiration of the 10-year period.

The holding of the Court of Appeals is diametrically contrary to the declared intent of Congress. Inherent in a Clifford trust is the retention by the grantor-trustee of broad powers of administration over the trust and a retained reversionary interest therein. As we have shown, the statutes enacted in 1954 specifically except Clifford trusts from the provisions relating to taxation of a grantor as the substantial owner of the trust. 26 U. S. C. § 673 recognizes that the reversionary interest of a grantor of a Clifford trust shall not have the effect of causing him to be treated as the owner thereof.

As to the power to allocate trust receipts between principal and income, on which the Court of Appeals placed much emphasis and significance, we call attention to 26 U. S. C. § 674 (Appx. pages 22, 23). Under Section 674 (a) a grantor is to be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or income is subject to a power of disposition exercisable by the grantor without approval of an adverse party. Section 674 (b) (8) provides for exceptions including (Appx. 23) *"Power to allocate between corpus and income.* A power to allocate receipts and disbursements as between corpus and income, even though expressed in broad language."

The Court of Appeals in holding that Ringwalt individually "was the beneficial owner" of the trust for taxation purposes within § 368 (a) and (c) so that there was continuity of control and a reorganization, disregarded the mandate of Congress as disclosed by the provisions of Subpart E of Part 1 of Subchapter J.



As we have noted, the decision of the Court of Appeals which we urge this Court to review on Certiorari conflicts with *Commissioner of Internal Revenue v. Bergash, supra.* It also conflicts with the principal announced in *Commissioner of Internal Revenue v. Gordon,* 2 Cir. 1967, 382 F. 2d 499, holding that the Commissioner, who then urged a very strict construction of the reorganization statutes, was precluded from changing his position on strict or broad construction to suit his purpose in the particular instance, and that in determining tax results the Court should view the business transaction as a whole in conjunction with the underlying purpose of the statutes.

The Court of Appeals also failed to give effect to 26 U. S. C. § 318 (Appx. 16, 17) relating to constructive ownership of stock for purposes of Subchapter C (regarding corporate distributions and adjustments) and to cases construing § 318. The claim that Ringwalt was the beneficial owner of the R & L, Inc. stock during the existence of the trust is in effect a claim of constructive ownership at that time. Section 318 includes numerous specific rules for dealing with constructive ownership, none of which provides for application to §§ 331, 337, or 368. Section 368 (c) defines "control" for the purposes of Parts I, II, and III of Subchapter C relating to corporate distributions and adjustments (other than § 304 of Part I) and does not purport to fall within the ambit of § 318. Nor is § 368 (c) referred to in § 318 (b). On the other hand, by way of example, 26 U. S. C. § 304 (c) defining "control" in another context specifically states in subparagraph 2 that § 318 (a) shall apply for purposes of determining control, and § 304 is specifically referred to in § 318 (b).

The courts hold that § 318 (a) applies exclusively to the sections referred to in § 318 (b). See *Estate of Byrd v. Commissioner of Internal Revenue,* 5 Cir. 1967, 388 F. 2d 223; *Stanton v. U. S.,* D. C. E. D. Penn., 1974, 371 F. Supp. 103. In *Stanton* it was held that § 318 (b) of the Code specifically precludes application of the constructive ownership rules thereof to § 368 by its failure to refer to that section. In the instant case the Court of Appeals did not refer to § 318 although it was specifically called to the Court's attention.

As indicated on page 4, supra, the decision of the Court of Appeals made short shrift of the contention disclosed by the second question presented for review herein. In footnote 11 (Appx. 9) the Court stated that the contention "was not raised at trial" and was contradicted by the conclusion of the Court of Appeals that Ringwalt should be characterized as the owner of the short-term trust.

First we note that the issue was within the broadly pleaded allegations of the complaint in each of the Ringwalt cases, and that it arose only because of the district court's holding adverse to the taxpayers on the main question. There was no reason to litigate the matter in the trial court.

Under the terms of the trust Ringwalt individually could in no event receive income in the nature of corporate dividends prior to May 1, 1969, when the Clifford trust terminated. Assuming, arguendo, that there was a corporate reorganization, distribution of proceeds of the liquidation of R & L, Inc., which was added to the trust corpus in 1967, was not taxable as ordinary income to Ringwalt in 1967 but only in 1969 when the trust terminated and the trust corpus reverted to Ringwalt.



Under 26 U. S. C. § 677 (a) (2), providing that capital gains become a part of the corpus of a Clifford trust payable to the grantor on termination of the trust, the capital gains from the sale of securities comprising corpus constitute income "accumulated for future distribution to the grantor". See *Commissioner of Internal Revenue v. Wilson,* 7 Cir. 1942, 125 F. 2d 307; *Graff v. Commissioner of Internal Revenue,* 7 Cir. 1941, 117 F. 2d 247; *Scheft v. Commissioner of Internal Revenue,* 1972, 59 T. C. 428. For that reason, Mr. Ringwalt treated the R & L, Inc., distribution to the trust as part of the principal set aside for return to himself individually on termination of the trust and taxable to himself individually to the extent of the long-term capital gain realized in the taxable year of distribution. That is in no way inconsistent with the position that the trust owned the corpus and that the gain to the trust estate from the sale of the National Fire & Marine Stock distributed in the course of liquidation of R & L, Inc., was not and could not be ordinary income to Ringwalt in the nature of corporate dividends in 1967.

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## CONCLUSION

The decision of the Court of Appeals violates the statutory mandate of Congress regarding treatment, taxwise, of Clifford trusts as applied to corporate liquidations and reorganizations. It also violates common-law principles of trusts. It is, to say the least, incompatible with decisions of Courts of Appeals of other circuits.

Involved herein are questions of continuing importance in the field of taxation. This Court has the oppor-

tunity to settle now questions of Federal law regarding the revenue which must eventually be determined. While in this particular case the Treasury gains by the strained construction given to the applicable statutes, and the taxpayers pay a heavy penalty for failure to anticipate that construction, there will doubtless be many instances in the future when the decision of the Court of Appeals if permitted to stand will return to haunt the Treasury and, if followed, prove this to be an empty victory indeed. As stated by the Court of Appeals for the First Circuit in *Lewis v. Commissioner of Internal Revenue,* 1 Cir. 1949, 176 F. 2d 646 at page 648:

> "Sometimes the taxpayer seeks to establish that a statutory reorganization did not take place. E. g., Survaunt v. Commissioner, 8 Cir. 1947, 162 F. 2d 753. Other times the Commissioner takes that position. E. g. Bazley v. Commissioner, 1947, 331 U. S. 737, 67 S. Ct. 1489, 91 L. Ed. 1782, 173 A. L. R. 905. Our determination of the substantive question must not be controlled by whether in the particular case it is to the advantage of the government or of the taxpayer to make out that no statutory reorganization has been effected. See Lyon, Inc. v. Commissioner, 6 Cir. 1942, 127 F. 2d 210, 213. 'Rather, the effort should be to seek out the true intendment of the law, let the chips fall how they may in the particular litigation. Otherwise, to change the metaphor, interpretative chickens may come home to roost at a time when the barnyard wears quite a different aspect.' Portland Oil Co. v. Commissioner, 1 Cir., 1940, 109 F. 2d 479, 488."



Petitioners respectfully pray that certiorari be granted herein to review the judgment and decision of the United States Court of Appeals for the Eighth Circuit.

Respectfully submitted,

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